

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE MOQHAKA LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Mqohaka Local Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ~~XX to XX~~.

Accounting Officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. Despite after attempting alternative procedures, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness, existence and valuation of and the rights to property, plant and equipment amounting to R1 118 122 256 (2009: R1 085 284 038), as disclosed in note 1 to the financial statements, due to the following:
 - (a) The fixed asset register of the municipality was reconstructed during the previous financial year. Engineering experts were required to determine fair values for the infrastructure assets as an acceptable substitute for historical cost in terms of GRAP Directive 7. This entailed the use of various technical engineering assumptions and judgements. I was unable to obtain sufficient appropriate audit evidence as to the consistent application of the expert's methodology due to a lack of appropriate documentation. This led to significant unresolved uncertainties around the reasonability and reliability of the valuations performed on infrastructure assets.

- (b) Unique identification was not allocated to asset components in the asset register and the required title deeds that could either not be obtained or title deeds not confirming ownership. Furthermore, a number of land and buildings registered in the name of the municipality could not be traced to the fixed asset register and the asset register did not contain adequate descriptions, unique identification and locations to physically confirm the completeness of property, plant and equipment. (R41 345 729 + R80 298 663) (2009: R22 445 307)
5. Paragraph 11 of the Statement of Generally Recognised Accounting Practise, GRAP 17: Property, plant and equipment (GRAP 17), states that an asset should be recognised when it is probable that future economic benefits or service potential associated with an item will flow to the municipality and the cost or fair value of the item can be measured reliably. Contrary to the prescribed accounting treatment, management opted not correct the following errors:
- (a) Property, plant and equipment and accumulated surplus, as disclosed in the statement of financial position, are understated due to an infrastructure asset of the municipality not being included in the asset register. Due to the lack of sufficient appropriate audit evidence, it was impracticable to determine the total extent of this understatement.
 - (b) The management of the municipality did not recognise Municipal Infrastructure Grant (MIG) costs relating to assets under construction as property, plant and equipment in the previous year. These costs were recognised as expenditure in the previous year and the projects were only recognised as property, plant and equipment once the projects had been finalised. The municipality's records did not permit me to determine to what extent the property, plant and equipment of the previous year is understated.

Revenue

6. I was unable to obtain sufficient appropriate audit evidence as to the completeness, accuracy, occurrence and classification of revenue disclosed as R368 385 977 (2009: R289 370 704) in the statement of financial performance, due to the following matters and the municipality's records not permitting the application of alternative procedures:
- (a) It could not be determined if all money received by the municipality was recognised in the general ledger. This was mainly due to receipts that were not being sequentially numbered and sequence gaps that could not be supported by appropriate audit evidence.
 - (b) A number of water and electricity meters were identified which were not in working condition during the current year and at year-end. Due to the total extent and consequent impact of this not being determinable, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and accuracy of services revenue.
 - (c) Sufficient appropriate audit evidence could not be obtained for pre-paid electricity transactions amounting to R9 327 415 and a difference amounting to R3 604 776 with which the pre-paid electricity transactions in the accounting records exceeded the amounts received from consumers.
 - (d) I could not confirm that journals that increased revenue, as disclosed in the statement of financial performance, by R5 703 286 during the current year should have been processed or were recorded in the correct accounts and at the correct amounts as they were not supported by appropriate supporting documentation.
 - (e) Sufficient appropriate audit evidence could not be obtained for the prior period errors disclosed in note 43.19 to the financial statements relating to property rates, service charges and other income amounting to R1 417 440 that was not recognised in the

previous year.

- (f) I was unable to obtain audit evidence that all rental income was recognised. This was mainly due to the municipality not performing adequate rental revenue reconciliations, a complete listing of all municipal rentals that could not be obtained and the lack of a clear audit trail.
 - (g) Sufficient appropriate audit evidence could not be obtained to support rental income transactions amounting to R419 076 and for discounts granted on rental income amounting to R599 495. In addition, supporting documentation could not be obtained for a difference amounting to R597 356 with by which a rental income amount banked exceeded the accounting records.
 - (h) Sufficient appropriate audit evidence could not be presented for revenue relating to fines of the previous year, as disclosed in the statement of financial performance amounting to R765 069.
 - (i) Sufficient appropriate audit evidence, including indigent application forms and an indigent register, could not be obtained to confirm indigent subsidies granted, which reduced services revenue.
 - (j) I was unable to obtain audit evidence that all reconnection income was recognised. This was mainly due to the municipality not maintaining a reconnection register that is reconciled with reconnection deposits that were received.
7. Property rates revenue is understated as properties were identified for which rates have not been charged due to these properties being incorrectly classified as municipal properties. Furthermore, properties were identified for which the amount of improvements made exceeded the amount with which the property value was increased in the accounting system. The category of these properties could not be reliably determined and accurate municipal valuations did not exist for certain of these properties. It was therefore impracticable to determine the total extent of this understatement.
8. In accordance with SA Standards of GRAP, GRAP 1 *Presentation of financial statements* (GRAP 1), transactions should be recorded when they occur. Management did not estimate usage of water and electricity meters from the last date that the meters were read up to the end of the financial year. This was mainly due to these calculations not being performed by management at year-end. Revenue and consumer receivables from exchange transactions are understated with an estimated amount of R717 454.
9. Paragraph 125 of the Framework for Preparation and Presentation of Financial Statements states that revenue is recognised when an increase in future economic benefits or service potential related to an increase in an asset or a decrease of a liability has arisen. Revenue from indigent consumers amounting to R3 912 320 were incorrectly recognised as service charges revenue and general expenses in the statement of financial performance. This was mainly due to indigent subsidies not being offset against service revenue but recognised as general expenses. Service charges revenue and general expenses is therefore overstated by R3 912 320.

Expenditure

10. The occurrence, completeness and accuracy of depreciation amounting to R45 000 356 (2009: R44 489 855) as disclosed in the statement of financial performance could not be confirmed due to the limitations experienced regarding the valuation of property, plant and equipment (refer to paragraph 4 of this report). The municipality's records did not permit the application of alternative procedures.

11. Management did not provide sufficient appropriate audit evidence to confirm the accuracy and occurrence of expenditure transactions amounting to R3 244 094, as disclosed in the statement of financial performance. I could also not obtain sufficient appropriate audit evidence in respect of journals amounting to R9 903 157 that were recorded in expenditure. The system of control over the recording and classification of expenditure was not adequate and, as a result, there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all these expense transactions occurred and were accurately recorded and classified in the financial records of the municipality.

Consumer receivables from exchange transactions

12. The existence, completeness and valuation of consumer receivables from exchange transactions amounting to R51 381 008 as disclosed in note 7 to the financial statements could not be confirmed due to the following matters and the municipality's records not permitting the application of alternative procedures:
- (a) Sufficient appropriate audit evidence could not be obtained to confirm consumer receivables from exchange transactions amounting to R55 678 645. This was as a result of no payments being made on these receivables subsequent to year-end and audit evidence not being obtained to confirm that all money received by the municipality was recognised in the accounting records.
 - (b) I could not confirm that journals that decrease consumer receivables from exchange transactions, as disclosed in the statement of financial position, by R4 330 739 should have been processed or were recorded in the correct accounts and at the correct amounts as they were not supported by appropriate supporting documentation.
13. In terms of the South African Statement of Generally Accepted Accounting Practice, IAS 39 Financial Instruments: Recognition and Measurement (IAS 39), if objective evidence of impairment exists for financial assets, and those assets cannot be assessed individually for impairment, the assets should be included in categories of financial assets with similar credit risk characteristics and collectively assessed for impairment. The impairment of receivables amounting to R166 574 918, as disclosed in note 7 to the financial statements, were not based on receivables included in categories with similar credit risk characteristics. Due to the lack of sufficient appropriate audit evidence it was impracticable to determine the total extent of this misstatement.
14. In accordance with GRAP 1, transactions should be recorded when they occur. Other receivables from exchange transactions, as disclosed in the statement of financial position and note 8 to the financial statements, are understated with R1 016 789. This is mainly due to the municipality not identifying these amounts as being receivable on year end. Due to the lack of sufficient appropriate audit evidence it was impracticable to determine the total extent of this misstatement.
15. Suspense accounts were not cleared regularly and before the preparation of the financial statements. Consequently, unallocated amounts of the previous year amounting to R480 308 were disclosed as other receivables from exchange transactions in note 8 to the financial statements. I was unable to confirm the total extent of income, expenditure, assets or liabilities that might be included in these amounts as sufficient appropriate audit evidence could not be presented and alternative procedures could not be performed.
16. Paragraph 11 (a) and (b) of GRAP 17, states that the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits or service potential associated with the item will flow to the entity, and the cost or fair value of

the item can be measured reliably. Items of property, plant and equipment of the previous year amounting to R1 392 389 are incorrectly included in unallocated amounts as presented in note 8 to the financial statements and therefore results in an overstatement of other receivables from exchange transactions of the previous year. These items could not be traced to the fixed asset register as the supporting documentation could not be aligned with assets in the register. Since the asset register was reconstructed and comparative information restated, I could not determine whether this matter results in an understatement of property, plant and equipment or an overstatement of accumulated surplus.

Loans and borrowings

17. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of loans and borrowings amounting to R36 229 467 presented in the statement of financial position and disclosed in note 11 to the financial statements.
 - (a) Sufficient appropriate audit evidence including, external confirmations could not be obtained for loans amounting to R15 781 348. Furthermore, sufficient appropriate audit evidence could not be obtained for the prior period error disclosed in note 43.21 to the financial statements relating to the recognition of finance charges amounting to R1 473 851 not previously recognised.
 - (b) I could not confirm that journals that increased loans and borrowings, as disclosed in the statement of financial position, by R6 431 160 should have been processed or were recorded in the correct accounts and at the correct amounts as they were not supported by appropriate supporting documentation.

Alternative procedures could not be performed due to the lack of documented evidence.

Investment property

18. I was unable to obtain sufficient appropriate audit evidence to confirm the valuation investment property amounting to R23 213 775 (2009: R23 355 009), as disclosed in the statement of financial position. I was unable to confirm the assumptions used by the expert regarding the cost, original purchase date of the property and the remaining useful lives of the property.
19. Paragraph 18 of the Statement of Generally Recognised Accounting Practise, GRAP 16: *Investment Property* (GRAP 16), states that investment property shall be recognised as an asset when it is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity and the cost or fair value of the investment property can be measured reliably.. Investment property is understated due to municipal properties, which are being leased out, not being included in the investment property register. Due to the lack of sufficient appropriate audit evidence it was not possible to determine the total extend of this understatement.

Payables

20. Sufficient appropriate audit evidence could not be presented for payments received in advance relating to the previous year amounting to R1 289 176 and the accounting system of the municipality did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence and valuation of payments received in advance during the previous year amounting to R9 240 873, as disclosed in note 15 to the financial statements.

21. I could not confirm that journals that decreased payables, as disclosed in the statement of financial position, by R8 854 727 should have been processed or were recorded in the correct accounts and at the correct amounts as they were not supported by appropriate supporting documentation. The municipality's records did not permit the application of reasonable alternative procedures. Consequently, the completeness and valuation of payables, as disclosed in the statement of financial position, could not be confirmed.
22. Included in payments received in advance are deposits amounting to R2 006 914 (2009: R827 945) which had not been allocated to debtors accounts at year-end. Consequently, payments received in advance, as disclosed in note 15 to the financial statements, are overstated and consumer receivables from exchange transactions, as disclosed in note 7 to the financial statements, are overstated by this amount.

Employee cost

23. Sufficient appropriate audit evidence could not be obtained for severance payments and housing allowances amounting to R1 541 247, included in employee related cost as disclosed in the statement of financial performance. Furthermore, no employment contracts or appointment letters could be obtained for employee-related costs amounting to R5 978 764 in the previous year. In the absence of sufficient appropriate audit evidence, the municipality's records did not permit the application of alternative procedures and therefore no assurance could be obtained that these costs had actually occurred and were accurately recorded. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the accuracy, completeness and occurrence of employee-related costs.

Value added Tax

24. The existence, valuation and completeness of the VAT receivable amounting to R3 129 980, as disclosed in note 17 to the financial statements, could not be confirmed due to the following:
 - (a) An amount of R4 005 583 was claimed in the financial year ended 30 June 2007 pertaining to input tax not claimed in prior periods. The accuracy and completeness of this amount could not be confirmed.
 - (b) The municipality was unable to reconcile the difference of R3 708 692 between the VAT balance, as disclosed in the financial statements, and the June 2010 VAT return submitted to SARS.
 - (c) Journals that decreased the VAT receivable by R750 931 could not be supported by appropriate supporting documentation.

The lack of a clear audit trail did not permit the application of alternative procedures.

Employee benefits

25. Sufficient appropriate audit evidence could not be presented for the accumulated leave provision amounting to R3 770 895 (2009: R3 452 721). Certain leave records could not be presented and the municipality did not have adequate leave registers and therefore alternative procedures could not be performed. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence, completeness and valuation of staff leave payable as disclosed in note 14 to the financial statements.

Commitments

26. The completeness, existence and valuation of commitments amounting to R58 526 685 (2009: R59 874 697), as contained in note 30 to the financial statements, could not be verified because the municipality does not have a contract register in place. Due to the lack of supporting documentation for these capital commitments, no alternative procedures could be performed.
27. Paragraph 83(c) of GRAP 17 states that the financial statements shall disclose for each class of property, plant and equipment recognised in the financial statements the amount of contractual commitments for the acquisition of property, plant and equipment. MIG project values were used to determine capital commitments amounting to R58 526 685 (2009: R59 874 697), as disclosed in note 30 to the financial statements. The project values do not necessarily represent actual contractual commitments and therefore capital commitments may be materially misstated. Due to the lack of a contract register and appropriate supporting records, I was unable to determine the extent the possible misstatement, if any.

Unauthorised expenditure

28. Section 1 of the MFMA defines unauthorised expenditure as any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11(3) of the act, and includes overspending of the total amount appropriated in the municipality's approved budget. Unauthorised expenditure as disclosed in note 42 to the financial statements is understated with an amount of R52 466 957 due to expenditure being incurred in excess of the budget per vote. However, the full extent of the misstatement could not be determined due to the limitations placed on the scope of the work performed relating to expenditure and suspense accounts (refer to paragraph 10 and 15 of this report). Consequently, the completeness and valuation of unauthorised expenditure could not be confirmed.

Irregular expenditure

29. I could not be provided with sufficient, appropriate audit evidence that management has properly identified, investigated and recorded all irregular expenditure transactions during the year under review. Due to the limitations placed on the scope of the work performed relating to expenditure and fixed assets procurement, there were no satisfactory alternative audit procedures that I could perform to confirm the completeness of irregular expenditure amounting to R20 072 972 (2009: R20 072 972) as disclosed in note 40 to the financial statements.
30. Section 1 of the MFMA defines irregular expenditure as expenditure incurred by a municipality that is not in accordance with a requirement of the act and that has not been condoned in terms of section 170. Irregular expenditure amounting to R1 635 717 was identified, which resulted from non-compliance with the municipality's supply chain management policy. This irregular expenditure was not disclosed as required by section 125(2)(d) of the MFMA and therefore irregular expenditure as disclosed in note 40 to the financial statements was understated by R1 635 717.

Fruitless and wasteful expenditure

31. A detailed breakdown of fruitless and wasteful expenditure amounting to R4 112 291, included in note 41 to the financial statements, could not be obtained. According to the financial statements this fruitless and wasteful expenditure was incurred due to the late payments of creditors. Furthermore, in the absence of this breakdown we could not confirm that interest accrued on loan payments in arrears amounting to R1 241 179 and interest

accrued on overdue third party payments amounting to R14 181 was included in the disclosure. Consequently, the completeness, existence and valuation of fruitless and wasteful expenditure could not be confirmed and no alternative procedures could be performed.

32. Fruitless and wasteful expenditure as disclosed in note 41 to the financial statements is understated due a contract that was cancelled by council that led to avoidable fees amounting to R111 547 being incurred. These payments are deemed to be fruitless and wasteful expenditure that were not disclosed in terms of section 125 of the MFMA.

Budget disclosures

33. According to GRAP 1, the municipality is required to provide information on whether its resources were obtained and used in accordance with the legally adopted budget. The comparison between the budget and actual amounts as disclosed in note 45 to the financial statements did not agree to the amounts disclosed in the statement of financial performance and the final approved budget:
- (a) Actual Interest earned on external investments and actual interest paid are overstated with R32 349 respectively.
 - (b) Actual employee cost is overstated with R1 149 673 and general expenditure departments understated with the same amount.
 - (c) It was not possible to determine the difference between the final adjusted budget approved by council and the budget disclosed in the note. This was due to the budget per line item not being updated with the adjustments as per the approved adjusted budget.

A reconciliation was not included in the note to indicate the reason for the variances.

Financial instrument disclosures

34. International Financial Reporting Standard, IFRS 7 Financial Instruments: Disclosures, (IFRS 7) requires detailed disclosure of information about exposure to risks arising from financial instruments. Contrary to the prescribed disclosure requirement, the management of the municipality did not adequately disclose the municipality's exposure to financial risk and how these risks are mitigated.
35. Paragraph 20(d) of IFRS 7 states that an entity shall disclose interest income on impaired financial assets accrued. Interest income on impaired consumer receivables from exchange transactions is not disclosed separately in note 7 to the financial statements. I was unable to quantify this understatement as sufficient appropriate audit evidence could not be presented and alternative procedures could not be performed.

Disclaimer of opinion

36. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the matters below. My opinion is not modified in respect of these matters.

Contingent liabilities

37. With reference to note 32.1 to the financial statements, the municipality is the defendant in several lawsuits. The municipality is opposing the claims based on legal advice obtained. The ultimate outcome of these matters cannot presently be determined. Contingent liabilities amounting to R7 994 021 (2009: R4 576 789) have been disclosed in the financial statements.

Restatement of corresponding figures

38. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during the 2009-10 financial year in the financial statements at, and for the year ended 30 June 2009. These restatements mainly related to revenue and expenditure not recognised in the correct accounting period.

Irregular expenditure

39. As disclosed in note 40 to the financial statements, irregular expenditure to the amount of R20 072 972 (2009: R20 072 972) was incurred mainly due to proper procurement processes not having been followed.

Unauthorised expenditure

40. As disclosed in note 42 to the financial statements, unauthorised expenditure to the amount of R10 285 536 (2009: R75 859 183) was incurred, as a result of proper budget monitoring process not having been followed.

Fruitless and wasteful expenditure

41. As disclosed in note 41 to the financial statement, fruitless and wasteful expenditure to the amounting to R5 656 157 (2009: R4 515 130) was incurred, mainly a result of payments not being made within the agreed payment terms.

Financial sustainability

42. As disclosed in note 37 and note 39 to the financial statements, there was a significant increase in accounts payable and the municipality may not be in the position to settle its current obligations in the normal course of business. The municipality incurred a substantial deficit in the current year, as disclosed in the statement of financial performance, and is experiencing serious difficulties with regard to debt collection. The municipality did not settle its debt within 30 days as required by the MFMA and is significantly dependent on the national and provincial government for its continued sustainability. These conditions, along with other matters, point to the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern. The municipality may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. These are indicators that the municipality may be facing serious financial problems in terms of section 138 of the MFMA.

Additional matters

I draw attention to the matters below. My opinion is not modified in respect of these matters:

Material inconsistencies in other information included in the annual report

43. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies in the financial statements.

Unaudited supplementary information

44. The supplementary information set out in appendices A to F on pages ~~XX to XX~~ does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

45. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA, Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and DoRA; and financial management (internal control).

Non-compliance with regulatory and reporting requirements

Inadequate content of integrated development plan

46. The integrated development plan of the municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.
47. The key performance indicators set by the municipality did not include all the general key performance indicators applicable to the municipality, as required by section 43(1) of the MSA.

Existence and functioning of a performance audit committee

48. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

49. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

Lack of adoption or implementation of a performance management system

50. The municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of sections 36, 38 and 41(2) of the MSA, and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

No mid-year budget and performance assessments

51. The accounting officer of the municipality did not assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

Content of the annual budget

52. The annual budget for the financial year ended 30 June 2010 was not based on the development priorities and objectives referred to in section 26(c) of the MSA and measurable performance targets were not set by the municipality as required by regulation 6 of the Municipal Planning and Performance Management Regulations, 2001.

Usefulness of information

The following criteria were used to assess the usefulness of the planned and reported performance:

- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- **Relevance:** Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- **Measurability:** Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable and time bound?

The following audit findings relate to the above criteria:

Reported information not consistent with planned objectives, indicators and targets

53. The municipality has not reported on its performance against predetermined objectives, which are consistent with the approved integrated development plan.

Planned and reported performance targets are not time bound

54. For the selected objectives, 100% of the planned and reported targets were not time bound in specifying the time period or deadline for delivery.

Reliability of information

The following criteria were used to assess the reliability of the planned and reported performance:

- **Validity:** Has the actual reported performance occurred and does it pertain to the entity, i.e. can the reported performance information be traced back to the source data or documentation?
- **Accuracy:** Have amounts, numbers and other data relating to reported actual performance been recorded and reported appropriately?

- Completeness: Have all actual results and events that should have been recorded been included in the reported performance information?

The following audit finding relates to the above criteria:

Reported indicators not reliable as no supporting source information was provided

55. For the selected objectives, the validity, accuracy and completeness of 55% of the reported indicators could not be established as the relevant source documentation could not be provided for audit purposes.

Compliance with laws and regulations

Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA)

56. Section 126(1)(a) was not complied with due to the fact that the accounting officer did not submit the financial statements for auditing within two months after year-end. Furthermore, the mayor did not table a written explanation setting out reasons for the failure to submit the financial statements in the council as required by section 133(1)(a).
57. Contrary to section 65(2)(e), payments were not always made within 30 days from receipt of the invoices.
58. The accounting officer did not comply with his legislative responsibility of managing the financial administration of the municipality in terms of section 62(1)(f)(iv) by not taking reasonable steps to ensure that the municipality implemented a supply chain management policy in accordance with chapter 11.
59. Contrary to regulation 121(1) of the MFMA, the annual report was not tabled to council within nine months after the end of a financial year.
60. Section 53(1)(c) of the MFMA was not complied with due to the fact that the mayor did not ensure that the council approve the municipality's service delivery and budget implementation plan within 28 days after the approval of the annual report.
61. Contrary to regulation 165 of the MFMA, internal audit did not substantially fulfil its responsibilities for the year.
62. Contrary to regulation 166 of the MFMA, the audit committee did not substantially fulfil its responsibilities for the year.
63. Contrary to regulation 16 of the MFMA, the mayor did not table the annual budget at a council meeting at least 90 days before the start of the budget year.
64. Contrary to regulation 54(2) of the MFMA, evidence could not be obtained that the mayor promptly responded to and initiated any remedial or corrective steps proposed by the accounting officer to deal with the municipality's financial problems and alerted the council and the MEC for local government in the province to those problems.
65. Contrary to regulation 17 of the MFMA, the annual budget of the municipality was not divided into a capital and operating budget as no capital budget was provided.
66. Expenditure was not incurred in accordance with the approved budget of the municipality and exceeded the limits of the amounts appropriated for the different votes in the approved budget of the municipality, resulting in unauthorised expenditure as defined in section 1.
67. Expenditure was incurred that was not in accordance with the requirements of the municipality's supply chain management policy, resulting in irregular expenditure as defined

in section 1.

68. Expenditure was incurred that could have been avoided had reasonable care been exercised, resulting in fruitless and wasteful expenditure as defined in section 1.

INTERNAL CONTROL

69. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives and compliance with the MFMA and DoRA, but not for the purposes of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the deficiencies regarding the basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

70. During the first half of 2009-10 financial year the municipality experienced a change in leadership at the accounting officer and chief financial officer levels in order to address leadership challenges that it had faced during the previous financial years. These challenges included the following issues that contributed to the weaknesses in the financial environment and the ultimate audit outcome:
- The previous accounting officer did not prioritise and take timely appropriate actions with regard to a lack of discipline in the finance and supply chain management directorates, resulting in non-compliance with applicable legislation and inadequate budget control measures. This, in turn, resulted in irregular, fruitless and wasteful as well as unauthorised expenditure.
 - The accounting officer did not prioritise and take timely appropriate actions with regards to rectify prior year audit findings.

Financial and performance management

71. The municipality did not have enough individuals who understand the financial reporting framework, performance and financial management requirements. This resulted in the municipality engaging a consultant to prepare their financial statements. However, the underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the accounting framework which resulted in the ultimate audit outcome.
72. The chief financial officer was on sick leave for a major part of the financial year. Subsequent to his resignation, the post of chief financial officer was vacant for a number of months. Consequently, the municipality did not have mechanisms in place to sufficiently monitor the recording and reconciliation of the financial records.
73. Manual and automated controls were not designed to ensure that the transactions had occurred, were authorised, and were completely and accurately processed. Documentation supporting amounts disclosed in the financial statements was not always available.
74. Management did not document and approve internal policies and procedures to address the process of collection, recording, processing, monitoring and reporting on performance information. Consequently, performance systems, processes and procedures had not been designed and implemented.

Governance

75. The risk of material misstatement due to fraud was not considered. Sufficient controls and segregation of duties to prevent or detect fraudulent data and asset misappropriation were not implemented and maintained.
76. The municipality did not respond to the assessed risks by determining a risk strategy and action plan to manage identified risks. Consequently, internal controls were not selected and developed to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.
77. The financial statements were subject to material corrections resulting from the audit, which are attributable to the lack of risk assessment performed, weaknesses in the design and implementation of internal control in respect of financial management, and financial reporting and weaknesses in the information systems.
78. The accounting officer did not prioritise the establishment of a fully functioning performance audit committee and internal audit function and therefore the functions were not established and functional during the financial year. This also resulted in the committees not being able to fulfil all their responsibilities.

OTHER REPORTS

Investigations

79. An investigation was conducted by a third party during the current financial year. The scope of the investigation was unknown on the date of this audit report.

Auditor-General
Bloemfontein

27 May 2011



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence